

## **DUTIES OF DIRECTORS**

What with Enron and Worldcom and all those other corporate scandals, a lot of people nowadays are turning their attention to the corporate boardrooms and the denizens that inhabit them. Following is a thumbnail sketch of what directors and others are supposed to be doing if they are not playing golf, conspiring with their crooked accountants or lying to the appropriate regulating agencies.

At its most basic, virtually all corporations are owned by the shareholders, governed by a board of directors and run by officers. Each group is different and has differing rights and responsibilities, though it is possible (and, in fact, common, particularly in small, closely-held corporations) for one person to be a shareholder, a director and an officer all at the same time.

Shareholders own the company and take all of the risks but they are also the primary beneficiaries of the rewards of success. They receive their rewards in the form of higher share prices and/or dividends. The officers (eg. president, vice-president, secretary, treasurer, etc.) are essentially employees of the company who carry out the day-to-day running of the business although they, too, usually get raises in the good times or pink slips in the bad.

Shareholders owe no duties to the company - they just own it. Officers and directors, however, are different, if for no other reason than that they are paid by the company. Directors owe a duty to the company to act honestly, in good faith and in the best interests of the company. They are also required to exercise the care, diligence and skill of a reasonably prudent person. Lastly, and quite importantly, they can be personally responsible if the company does not pay its employees.

The duty of honesty means a director must be truthful, open and above board with the other directors of the company. It also excludes a director from making any secret profits at the expense (real or theoretical) of the company. Finally, it requires that the director disclose any potential conflicts of interest and avoid any real ones.

Conflicts of interest between the director's personal interests and this duty to the company will

normally arise in one of three ways. The first is where the director either competes with his company, contracts with his company or is a director of another company that competes or contracts with his company.

The second is when the director does something that is motivated by something other than the best interests of the company or when the director does something ostensibly for one reason but which also has an important collateral purpose. The third way is when a director learns of or appropriates an opportunity for profit that should have gone to the company.

The duties of care, diligence and skill mean directors must have common sense, do their homework and keep themselves informed about what is going on in the company. While they don't have to attend all directors meetings religiously, they should make every effort to do so as they are deemed to know and approve of what takes place (unless they formally dissent shortly after they find out) even if they don't actually know in fact.

The duty of diligences does not mean that the director has to personally attend to getting things done or research every question. Directors are entitled to rely on others such as the officers, lawyers, engineers, accountants or others charged with doing the actual work. Similarly, directors are not expected to be experts in all fields. They frequently rely on outside specialists when circumstances require. However, they should make sure the folks they hire know what they are doing and they should know what the folks they hired are up to.

Lastly, the "skill of a reasonably prudent person" basically means that ignorance isn't much of an excuse if a reasonably prudent person would not have had too much trouble figuring things out. If you're a director of a software company you're expected to know the difference between a bit and a byte. If you are a director of a cattle company, you should know the difference between a steer and a bull and which end the feed goes into. If your chief financial officer is buying ranches in Argentina, it is your duty to find out if he is getting the money out of the company coffers. That's why they pay directors those big bucks, after all.